

IN THE SENATE OF THE UNITED STATES.

LETTER

FROM

THE SECRETARY OF THE INTERIOR,

TRANSMITTING

A copy of the report of the Government directors of the Union Pacific Railway Company for the fiscal year ended June 30, 1894.

DECEMBER 3, 1894.—Referred to the Committee on Pacific Railroads and ordered to be printed.

DEPARTMENT OF THE INTERIOR,
Washington, December 3, 1894.

SIR: I have the honor to transmit herewith, for the information of the Senate, a copy of the report of the Government directors of the Union Pacific Railway Company for the fiscal year ended June 30, 1894.

Very respectfully,

HOKE SMITH, *Secretary.*

The PRESIDENT OF THE SENATE.

NEW YORK, *August 28, 1894.*

SIR: The Government directors of the Union Pacific Railway Company hereby submit their report for the fiscal year ending June 30, 1894:

During the closing months of the fiscal year ending June 30, 1893, the earnings of the Union Pacific Railway Company had shown a tendency to decrease materially. The outcome of the business for July and August, 1893, was still more unfavorable. The earnings, both gross and net, showed alarming and persistent declines. The same symptoms were manifest throughout the whole system of the Union Pacific Railway Company, its branches, and allied lines. They were also reflected in the reports of the Northern Pacific Railroad Company, the Atchison, Topeka and Santa Fe, the Southern Pacific, and prevailed generally with almost equal severity throughout all the railroads in the United States west of the Missouri River. The causes which produced these extraordinary results were evidently deep seated, and could not rationally be attributed to passing business disturbances;

the constantly falling tide of earnings, which affected a whole continent, could not be explained as the result of temporary adverse conditions.

The actual figures for July and August, 1893, were as follows:

Union Pacific system.

	Month of July—			Month of August—		
	1893.	1892.	Increase+, decrease—.	1893.	1892.	Increase+, decrease—.
Miles operated.....	8, 166	8, 147	+19	8, 166	8, 147	+19
Gross earnings.....	\$2, 828, 873	\$3, 750, 149	—\$921, 276	\$2, 658, 115	\$4, 075, 290	—\$1, 417, 175
Expenses, excluding taxes.	2, 044, 293	2, 241, 167	— 196, 874	1, 915, 034	2, 461, 699	— 546, 664
Surplus.....	784, 580	1, 508, 982	— 724, 402	743, 081	1, 613, 591	— 870, 510

The early returns for the month of September indicated that these unfavorable results would continue. The administration of the Union Pacific Railway Company, and of the various auxiliary companies which constituted the Union Pacific system, became satisfied that it would be entirely impossible to meet its fixed charges for interest, and the obligations by way of guarantees and of traffic contracts which the Union Pacific Railway Company had assumed.

The Union Pacific system, as it existed in 1893, consisted roughly of the following divisions:

	Miles.
The Union Pacific Railway Company.....	1, 822
Branches in Nebraska, Kansas, Colorado, Wyoming, Utah, and Montana.....	2, 388
Oregon Short Line and Utah Northern.....	1, 425
Oregon Railway and Navigation Company.....	1, 059
The Union Pacific, Denver and Gulf, and Fort Worth and Denver City Railway companies.....	1, 472
Total.....	8, 166

It was believed that this vast system of railways possessed a greater earning power when operated as a whole than if dismembered. For the purpose, therefore, of preserving the system in its integrity, a suit was brought by Oliver Ames, 2d, and others against the Union Pacific Railway Company and all the various railway companies which formed parts of the system. The general scope of the averment of the bill was that, by reason of the enormous decrease of net earnings, the defendant companies were not able to meet their fixed charges and the obligations of the traffic contracts; that the preservation of the system as a whole was of great importance to all holders of the securities of the various companies, and for the purpose of preserving the integral and harmonious management of all the companies together, the court was asked to appoint receivers, whose duty it should be to operate the system as a whole, to pay all expenses of operation and maintenance and taxes, and to apply such surplus net earnings as might remain, in accordance with the equitable rights of the several defendant companies, or of the holders of their securities, as the court might direct.

On the 13th of October, 1893, the United States circuit court, sitting at Nebraska, appointed Mr. S. H. H. Clark (president of the Union Pacific Railway Company), Mr. Oliver W. Mink (one of the vice-presidents), and Mr. E. Ellery Anderson (one of the Government directors), receivers of the various properties of the defendants. Subsequently,

on the suggestion of the Attorney-General, Mr. Frederic R. Coudert and Mr. John W. Doane (one of the Government directors) were also appointed.

The receivers immediately entered upon the discharge of their duties. The administration of this vast property presented questions of great complexity. The receivers found the Union Pacific Railway Company loaded down with a burden of obligations entirely beyond its power to discharge. The guaranty of all interest accruing on all bonds of the Oregon Short Line and Utah Northern, on all bonds of the Oregon Railway and Navigation Company, and the undertaking to pay a dividend of 6 per cent on \$24,000,000 of stock of the last-mentioned company, involved from the inception and expenditure vastly greater than the entire net earnings of these properties, even after including therein a liberal estimate of the derived business and indirect benefits which might be claimed to have resulted from the contracts containing the said guarantees.

The undertaking to pay the interest on all the bonds of the Union Pacific, Denver and Gulf Railway Company was equally disastrous. There were many other traffic contracts involving smaller amounts, but all resulting in serious loss to the Union Pacific Railway Company, into the details of which it is not necessary to enter; but we feel that we are entirely within bounds in saying that the result of the guaranty, traffic, and construction contracts entered into by the Union Pacific Railway Company since 1887 have caused that company a loss exceeding \$7,000,000, and have been an important if not the controlling factor in causing the bankruptcy of the company.

As the earnings of all the companies which were placed in the hands of the receivers fell very far short of the amount required to meet the obligations of these executory contracts, the receivers were immediately confronted with the necessity of determining upon an equitable application of such earnings as were made, and were compelled to adopt a principle for the administration of the property and for determining the obligations which they should first meet, and those from the performance of which they should ask the court to relieve them.

In regard to the administration of the property the policy of the receivers has been to keep up to the full standard the physical condition of all the railroads in their charge. During their administration, 26,000 tons of steel rails have been ordered and in large part laid, liberal expenditures for maintenance of way have been made, and the rolling stock has been kept in good condition. All expenditures of every kind have been charged against income. For this reason, as well as for the reason that when earnings decrease it is impossible to decrease operating expenses in the same proportion, the percentage of operating expenses is very large, and the percentage of income available for payment of interest is correspondingly small.

In furtherance of the policy of applying net earnings, so as to conform to the equities and rights of the various defendant companies and of the holders of their securities, the receivers have kept separate accounts of the receipts and expenses of the respective properties which have been intrusted to them. They have considered it to be their duty to administer these properties as though they had been appointed receivers in suits brought to foreclose the various mortgages which cover them. They have adopted the principle that net earnings made on rails covered by a particular mortgage should be applied to the payment of interest accruing on bonds issued under such mortgage in preference to being applied to the payment of interest accruing upon

mortgages covering other properties or in satisfaction of outstanding executory contracts of the Union Pacific Railway Company. Whenever the net earnings of a particular division have been clearly sufficient to meet the interest accruing on a mortgage covering such division, the receivers have obtained authority from the court and have applied the net earnings accordingly. When the net earnings of a particular division equal only a part of the interest accruing thereon, the particular company making such partial net earnings has been credited therewith for the ultimate benefit of those thereto entitled. The following interest payments have been made, or ordered to be made, since the appointment of the receivers:

	Due date.	Amount.	Total.
Union Pacific:			
Kansas Pacific, Denver Extension, first mortgage 6s	Nov., 1893	\$176,610	
Kansas Pacific consolidated mortgage 6s (part)	do	131,606	
Kansas Pacific, Middle Division, first mortgage 6s	Dec., 1893	121,890	
Union Pacific Railway collateral trust 5s	do	116,925	
Union Pacific Railroad first mortgage 6s	Jan., 1894	816,870	
Union Pacific Railroad collateral trust 6s	do	111,160	
Kansas Pacific, Eastern Division, first mortgage 6s	Feb., 1894	67,200	
Union Pacific Railroad sinking fund 8s	Mar., 1894	149,200	
Union Pacific Railroad, Omaha Bridge, first mortgage 8s	Apr., 1894	22,440	
Union Pacific Railway equipment trust 5s	do	33,475	
Union Pacific Railway collateral trust notes, 6s, eleven monthly installments, Oct., 1893, to Aug., 1894, inclusive		615,260	
Total Union Pacific			\$2,361,630
Oregon Short Line and Utah Northern:			
Utah and Northern first mortgage 7s	Jan., 1894	20,125	
Utah Southern general mortgage 7s	do	53,410	
Utah Southern Extension first mortgage 7s	do	33,880	
Idaho Central first mortgage 6s	do	1,440	
Utah and Northern consolidated mortgage 5s	do	45,775	
Oregon Short Line first mortgage 6s	Feb., 1894	447,930	
Utah and Northern equipment trust 5s	Apr., 1894	3,550	
Total Oregon Short Line and Utah Northern			606,110
Oregon Railway and Navigation:			
First mortgage 6s	Jan., 1894		148,260
Central Branch, Union Pacific Railroad Co.:			
Atchison and Pike's Peak first mortgage 6s	Nov., 1893	48,000	
Central Branch funded interest 7s	do	22,050	
Total Central Branch			70,050
Kearney and Black Hills Railway Co.:			
First mortgage 5s	Nov., 1893	642	642
Union Pacific Coal Co.:			
First mortgage 5s	do	1,175	1,175
Total payments for interest on bonds			3,187,867
In addition to the payments thus made for interests upon bonds, there has been retained by the United States amounts due for transportation of troops, mails, and supplies upon the lines of the Union Pacific Railway Co., from Oct. 13, 1893, the date of the receivership, to June 30, 1894, aggregating			
			837,570
Grand total of interest payments and amounts retained by the United States			4,025,437

Several of the branch railroads forming part of the system have not earned their operating expenses. As these operating expenses are paid from the general funds of the system, it follows that the balance available for the purpose of meeting partially earned interests will be considerably less than the aggregate of the sums standing to the credit of the railroads which earn surpluses. The deficiencies, of course, stand as amounts due to the general fund from the particular companies against which they are charged, but unless they can be collected the necessary result is a loss which must be charged against the companies which earn surpluses, or some of them.

For the purpose of defining their duties in relation to the proper disposition of these deficiencies, the receivers have applied to the court,

after giving full notice to all parties who could be affected thereby, including the Attorney-General as representing the interests of the United States. The result of this proceeding has been a direction to surrender the Denver, Leadville and Gunnison Railway, whose operation has for many years resulted in a very large deficiency, to a receiver appointed on the application of the trustee of its mortgage. This property was accordingly surrendered to Mr. Frank Trumbull, the receiver so appointed, on the 7th of August, 1894. Applications relating to other branches which result in deficiencies have been referred to Judge W. D. Cornish, as master, to take proofs, and such orders as to the continued operations of these branches as may be deemed proper will be made by the court after the master's report shall have been made. It may, however, be assumed that the court will not permit companies which earn surpluses to be charged with the deficiencies resulting from the operation of branches, except when the earnings derived from the branches and accruing to the companies against which the charge is to be made can be clearly shown to be in excess of the deficiency so to be charged.

It is manifest that the United States, as the largest creditor of the Union Pacific Railway Company, has an interest in the proper determination of all these questions, even if the Union Pacific Railway Company be treated as a hopelessly insolvent corporation. Any application of its resources which tends to deplete its assets, decreases, of necessity, the proportion of the entire debt of the United States which could be realized either from a distribution of its assets in bankruptcy or from a reorganization of the property.

Referring again to the extraordinary and burdensome contracts guaranteeing the payment of interest on the bonds of the Oregon Short Line and Utah Northern, of the Oregon Railway and Navigation Company, and of the Union Pacific, Denver and Gulf Company, as long as the interest on these bonds was regularly paid, the holders of their securities gave but little attention to the general administration of their properties. As soon, however, as it became clear that a continuance of such payments was impossible, the respective bondholders whose interest remained unpaid became uneasy. Committees of protection were formed, investigations, more or less complete, of the traffic arrangements between the different parts of the system and of the factors determining the distribution of earnings and of operating expenses, were made. The contemplation of constantly diminishing earnings aroused a more or less defined suspicion that the particular interests of certain parts of the system were sacrificed for the advantage or benefit of other parts. The representatives of particular securities concluded that an administration of the properties in which they were interested, controlled entirely in their own interest and separated completely from the system which had failed to produce satisfactory results, would be to their advantage. This sentiment or conviction has caused the institution of proceedings in court, looking to a separate administration of certain parts of the system. The result of these proceedings has been the appointment of separate receivers of the Union Pacific, Denver and Gulf Railway Company and of the Oregon Railway and Navigation Company. On the 18th of December, 1893, all of the properties of the Union Pacific, Denver and Gulf Company, including the various branches in Colorado and the Julesburg Cut-off, were surrendered to Mr. Frank Trumbull, who was appointed separate receiver of these properties.

On the 3d of July, 1894, all the properties of the Oregon Railway and Navigation Company were surrendered to Mr. Edward McNeill, who

was appointed its separate receiver. The properties thus surrendered, including the Denver, Leadville and Gunnison Railroad Company hereinbefore referred to, embraced in all over 2,500 miles of railroad, or more than one-fourth of the property originally included in the receivership of the Ames suit.

In our opinion there is no foundation for the suggestion that the particular or local interests of any part of the system have been sacrificed for the benefit or advantage of other parts; and while it may be true that certain temporary and local advantages resulting from favorable traffic contracts may be reached through separate administration of the properties above referred to, we believe that a dismemberment of the system will very largely impair its value and its earning power.

If this view is correct it will be readily seen that the security held by the United States for the large debt due from the Union Pacific Railway Company would be greatly impaired by a disruption of the system, and that the Government is deeply interested in promoting any plan of reconstruction which will prevent a disintegration of the system and which will secure to it the largest possible return.

Very shortly after the appointment of the receivers a committee was constituted for the purpose of preparing a practical plan for the reorganization of the system. This committee consisted of the Hon. Calvin S. Brice, J. Pierpont Morgan, Louis Fitzgerald, Grenville M. Dodge, A. A. H. Boissevain, Henry L. Higginson, and Samuel Carr. These gentlemen represented a very large amount of all classes of securities. It was not possible to represent the Government of the United States by an agent armed with any power to speak or act for it, but it was intended by the presence of Senator Brice on the committee and by constant conference with the Attorney-General to prepare a plan which would be in harmony with the interests of the United States and acceptable to Congress.

This committee has labored zealously to accomplish its objects. The principle upon which it has proceeded has been that the terms of settlement with the United States must be adjusted before any proposition could be made to the general creditors. This, we think, was a mistake. The representatives of the United States, not having before them the whole proposition or any statement of the terms to be offered to other creditors, could not judge intelligently of the concessions which they were asked to make, and would naturally and by reason of their official relations insist upon a larger measure of payment or of security than the property could possibly be made to yield.

We are informed that the reorganization committee proposed no plan of its own. It outlined a number of suggestions which were submitted to the Hon. Richard Olney, Attorney-General, for such action as he might see fit to take. After many discussions and consultations the Attorney-General sent to the House of Representatives a letter dated April 26, 1894, containing a proposed bill entitled "A bill to reorganize the Union Pacific Railway Company, and to readjust and secure the claims of the United States against said company."

This bill was referred to the Committee on the Pacific Railroads, and full hearings of the representatives of the reorganization committee, of the receivers, and of other interested parties were had. A number of other bills relating to the same subject were referred to the House Committee. Subsequently, Mr. Reilly, the chairman of the committee, reported H. R. 7798 in lieu of H. R. 305, H. R. 4411, H. R. 6947, and H. R. 6950. Mr. Reilly's report is No. 1290.

It is provided by the third section of this bill that the moneys and securities in the sinking fund created pursuant to act of Congress of

May 7, 1878, shall be applied to part payment or extinction of existing first-mortgage bonds whose liens are prior to the lien of the United States; after such application there would remain about \$21,000,000 of such prior bonds.

Section 2 of the Reilly bill requires the company desiring to avail itself of the benefits of the proposed legislation to provide for the payment of all bonds having priority of lien over the United States.

Section 8 retains the existing statutory lien until the debt due to the United States shall be fully paid. It follows, therefore, that under the provisions of the Reilly bill the only securities available to the company to be used for the purpose of paying off the above-mentioned \$21,000,000 of bonds are securities which shall be subject to the Government lien and subject to all existing liens which are now subsequent to the lien of the Government. In our opinion this condition can not be complied with. It would be found simply impossible to raise \$21,000,000 on bonds subject to the lien of the Government.

It has been a prevalent idea in Congress and with the public that many important and valuable interests would be displaced by an enforcement of the Government lien, and that these interests could be safely relied on as certain to provide the money required for carrying into effect any adjustment which Congress might propose. This assumption has no foundation in fact. As far as the securities appertaining to the Oregon Railway and Navigation Company, to the Oregon Short Line and Utah Northern Railway Company, and to the Union Pacific, Denver and Gulf Company are concerned, the holders thereof have given abundant evidence that, so far from contributing anything for the retention of the Union Pacific system in its integrity, they are inclined to believe that they can produce better results by separate administrations of their respective properties. As far as the Union Pacific Railway Company itself is concerned, the only securities which would be displaced by a foreclosure of the Government lien are the sinking fund 8s, of which there are outstanding \$3,730,000; the Kansas Pacific consolidated 6s, of which there are outstanding \$11,724,000; the Kansas Division and collateral mortgage bonds, of which there are outstanding \$5,000,000, and the stock, amounting to \$61,000,000.

The sinking fund 8s and the Kansas Pacific consolidated 6s are largely secured by liens on land grants and by collateral bonds. Their liens on the railroad, which would be extinguished by the enforcement of the Government lien, form a very inconsiderable part of their security, and the holders of these bonds would advance nothing to stay a foreclosure of the public debt or to assist the railway company in complying with the requirements of the proposed Reilly bill.

The \$5,000,000 of Kansas Division and collateral mortgage 5 per cent bonds are held as additional collateral security in the Drexel-Morgan 6 per cent note trust; and, as the outstanding 6 per cent notes are substantially protected by other security, their holders would certainly advance nothing to avert a foreclosure of the Government lien.

As far as the stockholders are concerned, at present quotations, the whole market value of all the stock is about \$3,000,000. It is manifest that the scattered stockholders would be neither willing nor able to contribute a very large sum of money for the purpose of averting foreclosure. An assessment of perhaps \$10 a share might be successfully levied, but only by means of a plan which would give reasonable assurance of success and which would leave to the contributors some expectation of a return of their contributions.

As for the plan of attempting the collection of the Government debt

by acquiring title to the railroad property and operating it, the insuperable objection to this course, both from a political standpoint and in view of the peculiar and incomplete nature of the Government lien, have been so often stated that it is not necessary to repeat them.

The Government directors have given the subject of the adjustment of the Government debt very special and careful consideration since the appointment of the receivers. The situation appears to them critical and to call more urgently than ever for an intelligent settlement between the Government and the company. We beg leave, therefore, to report the following suggestions, which appear to us to give a vastly better result than could be obtained from a foreclosure of the Government lien and to be free from the impracticable difficulties contained in the Reilly bill. If they should meet your approval and the approval of the Administration, we ask that they be submitted to Congress for its consideration.

The plan is simply for the reorganization of the Union Pacific Railway Company. We have, however, added an application of this principle, so as to include the Oregon Short Line and Utah Northern Railway Company and the Oregon Railway and Navigation Company. The inclusion of the two last-named companies would, of course, be entirely dependent upon the approval of a large majority of the holders of their securities as well as upon the favorable action of Congress, but such inclusion, as will be seen, is not necessary to the success of the plan.

The plan is based on the following principles:

I. Ascertain the minimum net earning power of the railroad or railroads to be reorganized.

II. Subject the entire railroad or railroads to a single mortgage, under which issue 3 per cent 100-year bonds to an amount such that the accruing interest will not exceed the minimum earning power.

III. Ascertain the debt due to the Government by adding interest at 6 per cent to the principal of the bonds from their date to their maturity, crediting against same the amount of the United States bond and interest account and discounting the principal and interest so ascertained at 3 per cent per annum for an agreed date, say, July 1, 1895.

IV. Apply the moneys and securities in the sinking fund to the part payment or extinction of bonds which have priority of lien over the lien of the Government.

V. Assess the stock of the Union Pacific Railway Company \$10 per share. In default of payment of assessment, issue new stock for the amount thereof.

VI. Apply \$5,000,000 of the amount so raised to the further extinction of bonds having priority of lien over the lien of the Government.

VII. Sell so many of the first-mortgage 3 per cent 100-year bonds as shall be required to pay off the remainder of the existing prior-lien bonds at maturity.

VIII. Issue to the Government an amount of first-mortgage 3 per cent 100-year bonds equal to the whole debt as above ascertained.

IX. Apply the remaining 3 per cent first-mortgage bonds and so much preferred stock as may be necessary to compensate security-holders for reduction of interest to the satisfaction of liens subsequent to the lien of the United States and of the bonds held in the collateral trusts of the company.

X. Carry to foreclosure, decree, and sale the entire railroad property of the Union Pacific Railway Company, including the bonds and lands held in the collateral trusts.

The following statement presents a plan of reorganization based upon an application of these principles to the Union Pacific Railway Company.

The actual net earnings of the Union Pacific Railway Company during the fiscal year ending June 30, 1894, which may be safely taken as representing a maximum of disaster and a minimum of earnings, are as follows:

Gross earnings for year ending June 30, 1894.....	\$15,436,000
Operating expenses for the same period	\$9,983,000
Taxes, estimated on payments for 1893.....	594,000
	<u>10,577,000</u>
Net earnings for the year.....	4,859,000

Assuming, then, this amount as the minimum net earning power of the Union Pacific Railway Company, we suggest the following reorganization of the company and its branches in Nebraska, Kansas, Colorado, Wyoming, Utah, and Montana:

Securities to be issued.

Three per cent one-hundred-year gold bonds.....	\$150,000,000
Five per cent noncumulative preferred stock	20,000,000
Common stock.....	61,000,000

Application of securities.

	Amount.	Preferred stock.	Three per cent bonds.
Union Pacific first-mortgage 6s	\$27,229,000		
Kansas Pacific, Eastern Division 6s.....	1,936,000		
Kansas Pacific, Middle Division 6s.....	3,716,000		
Kansas Pacific, Denver Extension 6s.....	4,218,000		
Kansas Pacific, Leavenworth Branch 7s	15,000		
Total first-mortgage bonds	37,114,000		
Pay or cancel by United States sinking fund.. \$15,500,000			
Pay from stock assessment	5,000,000		
	<u>20,500,000</u>		
Leaving outstanding first-mortgage bonds	16,614,000		
Apply in satisfaction thereof 3 per cent bonds at 160			\$26,582,400
Debt to the United States, ascertained as of July 1, 1895	70,600,000		
Apply in satisfaction thereof 3 per cent bonds at par			70,600,000
Sinking-fund 8 per cent bonds	3,730,000		
Apply in satisfaction thereof 3 per cent bonds at 160			5,968,000
Union Pacific Railroad Company collateral trust 6 per cent bonds.....	3,672,000		
Apply in satisfaction thereof 3 per cent bonds at 150			5,508,000
Omaha Bridge 8 per cent bonds	561,000		
Apply in satisfaction thereof 3 per cent bonds at 160			897,600
Omaha Bridge renewal 5s	589,000		
Apply in satisfaction thereof 3 per cent bonds at 150			883,500
Equipment trust 5s	1,274,000		
Apply in satisfaction thereof 3 per cent bonds at 160			2,038,400
Collateral trust three-year notes 6s	11,430,000		
Apply in satisfaction thereof 3 per cent bonds at 150			17,145,000
Collateral trust 5s	4,677,000		
Apply in satisfaction thereof:			
Three per cent bonds at par			4,677,000
Preferred stock at 50		\$2,338,500	
Kansas Pacific consolidated 6s.....	11,604,000		
Apply in satisfaction thereof:			
Three per cent bonds at par			11,604,000
Preferred stock at 50		5,802,000	
Capital stock outstanding	61,000,000		
Amount of assessment thereon at \$10 per share, for which issue preferred stock at par		6,100,000	
Issue new common stock at par for old stock paying assessment			
Total.....		14,240,500	145,903,900
Balance first-mortgage 3 per cent bonds in Treasury			4,096,100
Balance preferred stock in Treasury		5,759,500	
Total.....		20,000,000	150,000,000

Create a sinking fund for the ultimate redemption of the 3 per cent first-mortgage bonds by vesting in the trustees of the general mortgage all the securities and lands now held in the Drexel-Morgan 6 per cent note trust, and in the collateral 6 per cent trust, and in the collateral 5 per cent trust.

Require the trustees of the general mortgage to invest the income derived from these securities and from the lands for account of their sinking fund. Require the trustees from time to time, and not less than once in every five years, to have an appraisal made of the securities and lands and cash in their sinking fund, and, whenever the value of the sinking fund so ascertained shall be less than a sum equal to the aggregate which would be reached by annual payments of \$800,000 each from the date of the mortgage to the date of such appraisal, together with interest thereon at the rate of 3 per cent per annum, compounded at the end of each year, require the company to pay into the sinking fund a sum sufficient to make up such deficiency.

The branches and properties in Nebraska, Kansas, Colorado, Utah, and Montana, which are now controlled by the Union Pacific Railway Company through the ownership of the bonds and stock of such branches, or of a majority thereof, would remain under the control of the trustees of the new general mortgage, and would, of course, be operated in harmony with the main railroad.

It is our opinion that the \$70,600,000 3 per cent first-mortgage bonds awarded to the Government under the plan above outlined would produce a better return than could be derived from a compulsory foreclosure. It also appears to us to represent as large a portion of the whole value of the property as can be awarded to the Government, and leave to those interested in the reorganization sufficient assets to effect a fair settlement with all the holders of its securities.

We are aware, of course, that no such plan can be carried through without the approval and cooperation of a large majority of the holders of all classes of securities; but, if the terms offered in the distribution of the securities are in general accord with their market values, it will, in our judgment, not be unreasonable to count on such approval. The amount required to meet the interest on the entire issue of 3 per cent bonds above suggested is less than the actual net earnings during the year ending June 30, 1894.

The annual payment to the United States would exceed \$2,000,000, and would be larger than the payments called for under the Reilly bill. The securities which immediately enter into the general mortgage sinking fund have an actual present value of over \$25,000,000, and, irrespective of the lands, their annual earning power exceeds \$800,000.

It is our judgment that no plan of reorganization can be carried into effect without complete foreclosure of the property of the company to be reorganized, including in such foreclosures all of its property held in the collateral trusts. While the receivers may be relieved by order of court from the actual performance of the obligations of the Union Pacific Railway Company, these obligations must remain in force as between the contracting parties themselves. As far as these obligations represent current obligations incurred in the operation of the property, they are all met and discharged within a very brief period after they are incurred. The receivers are carrying no floating debt except the obligations of each current month. The class of obligations which we refer to, and which render a foreclosure indispensable, are those growing out of executory contracts guaranteeing the payment of

interest, the traffic contracts and construction contracts hereinbefore referred to. Without a foreclosure these obligations would ultimately ripen into judgments against the company, which would remain forever as a cloud upon its title, and render its operation, except through the medium of a receivership, impracticable.

It is, therefore, absolutely necessary that the entire property of the Union Pacific Railway Company and all of its right, title, and interest in the securities and lands held in its various collateral trusts be foreclosed by appropriate proceedings. If the agreement for reorganization on the basis outlined above, or on any basis of distribution of securities acceptable to a large majority of the security holders, should be assented to, the usual proceedings for the foreclosures of the properties intended to be included in the reorganization, and their purchase by an appropriate committee authorized to carry the same into effect, are matters which present no difficulties. We refer to this subject because the suggestion has at times been made that a reorganization could be effected through the instrumentality of the present corporation and without actual foreclosure and sale. In our judgment this is utterly impossible. As, however, foreclosure would not cut off any creditor having an actual money demand against the company, but would merely cut off obligations under executory contracts which have become impossible of performance, it seems to us that there can be no objection to such foreclosures.

Our duties as Government directors are confined to the matters relating to the Union Pacific Railway Company itself; but, in view of what has been said of the value of the system and of the preservation of its integrity, we have thought it not out of place to report an extension of the principles of reorganization as hereinbefore applied to the Union Pacific Railway Company so as to include in the reorganization the Oregon Short Line and Utah Northern Railway Company and the Oregon Railway and Navigation Company.

Suggested basis for reorganization of the Oregon Short Line and Utah Northern Railway Company:

Gross earnings year ending June 30, 1894		\$5, 013, 000
Operating expenses for the same period	\$3, 302, 000	
Taxes estimated to be the same in 1894 as in 1893	221, 000	
		<u>3, 523, 000</u>
Net earnings for year ending June 30, 1894		<u>1, 490, 000</u>

Securities to be issued.

Three per cent one-hundred-year gold bonds	50, 000, 000
Five per cent noncumulative preferred stock	32, 000, 000
Common stock	27, 000, 000

S. Ex. 1—2

Application of securities.

	Amounts.	Preferred stock.	Three per cent bonds.
Oregon Short Line first mortgage 6s.....	\$14,931,000		
Apply in satisfaction thereof:			
Three per cent bonds at 140.....			\$20,903,490
Preferred stock at 40.....		\$5,972,400	
Utah and Northern first mortgage 7s.....	4,995,000		
Apply in satisfaction thereof:			
Three per cent bonds at 180.....			8,991,000
Preferred stock at 60.....		2,997,000	
Utah and Northern Consolidated 5s.....	1,891,000		
Apply in satisfaction thereof:			
Three per cent bonds at 140.....			2,563,400
Preferred stock at 30.....		549,300	
Utah and Northern Equipment Trust 5s.....	142,000		
Apply in satisfaction thereof 3 per cent bonds at 160.....			227,200
Utah Central first mortgage 6s.....	7,000		
Apply in satisfaction thereof 3 per cent bonds at 160.....			11,200
Idaho Central first mortgage 6s.....	131,000		
Apply in satisfaction thereof:			
Three per cent bonds at 160.....			209,600
Preferred stock at 40.....		52,400	
Utah Southern first mortgage 7s.....	424,000		
Apply in satisfaction thereof:			
Three per cent bonds at 160.....			678,400
Preferred stock at 40.....		169,600	
Utah Southern general mortgage 7s.....	1,526,000		
Apply in satisfaction thereof:			
Three per cent bonds at 160.....			2,441,600
Preferred stock at 40.....		610,400	
Utah Southern Extension 7s.....	1,950,000		
Apply in satisfaction thereof:			
Three per cent bonds at 160.....			3,120,000
Preferred stock at 40.....		780,000	
Oregon Short Line and Utah Northern consolidated 5s.....	10,895,000		
Apply in satisfaction thereof:			
Three per cent bonds at 80.....			8,716,000
Preferred stock at 50.....		5,447,500	
Oregon Short Line and Utah Northern collateral trust 5s. ¹	113,000,000		
Apply in satisfaction thereof preferred stock at par.....		113,000,000	
Oregon Short Line and Utah Northern stock.....	26,244,853		
Assess this stock \$5 a share, for which issue preferred stock at par.....		1,312,242	
Issue new common stock at par for all stock paying assessment.			
Total.....		30,890,842	47,861,800
Balance first mortgage 3 per cent bonds in Treasury.....			2,138,200
Balance preferred stock in Treasury.....		1,109,158	
Total.....		32,000,000	50,000,000

¹The \$13,817,200 of Oregon Railway and Navigation stock now held in the Oregon Short Line and Utah Northern collateral trust would pass to the trustees of the general mortgage and form a part of their sinking fund after the exchange of the collateral trust bonds for preferred stock.

Suggested basis for reorganization of the Oregon Railway and Navigation Company.

Gross earnings for year ending June 30, 1894		\$3,240,000
Operating expenses	\$2,735,000	
Taxes (estimated on payments for 1893).....	167,000	
		<u>2,902,000</u>
Net earnings for the year		<u>338,000</u>

Securities to be issued.

Three per cent one hundred-year gold bonds.....	20,000,000
Five per cent noncumulative preferred stock	<u>38,000,000</u>

Application of securities.

	Amount.	Preferred stock.	Three per cent bonds.
Oregon Railway and Navigation first mortgage 6s.....	\$4,942,000	.....	.....
Apply in satisfaction thereof 3 per cent bonds at 170.....	.....	.....	\$8,401,400
Oregon Railway and Navigation Consolidated 5s.....	12,583,000	.....	.....
Apply in satisfaction thereof:	.....	.....	.....
Three per cent bonds at 75.....	.....	.....	9,437,250
Preferred stock at 80.....	.....	\$10,066,400	.....
Oregon Railway and Navigation Collateral Trust 5s.....	5,182,000	.....	.....
Apply in satisfaction thereof:	.....	.....	.....
Three per cent bonds at 33 $\frac{1}{2}$.....	.....	.....	1,727,400
Preferred stock at 66 $\frac{2}{3}$.....	.....	3,454,600	.....
Oregon Railway and Navigation Company stock.....	24,000,000	.....	.....
Apply in satisfaction thereof preferred stock at par.....	.....	24,000,000	.....
Total.....	.....	37,521,000	19,566,050
Balance first mortgage 3 per cent bonds in Treasury.....	.....	.....	433,950
Balance noncumulative preferred stock in Treasury.....	.....	479,000	.....
Total.....	.....	38,000,000	20,000,000

The consolidation of the Union Pacific Railway Company, the Oregon Short Line and Utah Northern Railway Company, and the Oregon Railway and Navigation Company could be effected on the bases above set forth by executing a single mortgage covering all of their properties and issuing thereunder 3 per cent one hundred-year bonds equal in the aggregate to all the issues above suggested, and issuing in like manner 5 per cent noncumulative preferred stock and common stock equaling in the aggregate the shares above provided for. The figures would be as follows:

First mortgage bonds:		
Union Pacific Railway Company	\$150,000,000	
Oregon Short Line and Utah Northern	50,000,000	
Oregon Railway and Navigation Company	20,000,000	
Total.....	220,000,000	
Preferred stock:		
Union Pacific Railway Company	20,000,000	
Oregon Short Line and Utah Northern	32,000,000	
Oregon Railway and Navigation Company	38,000,000	
Total.....	90,000,000	
Common stock:		
Union Pacific Railway Company	61,000,000	
Oregon Short Line and Utah Northern Railway Company	27,000,000	
Total.....	88,000,000	

The fixed charges under these issues would amount to \$6,600,000, and the minimum net earnings, as tested by the returns of the year ending June 30, 1894, amount to \$6,689,600, but these figures are so far below the earnings of the same properties during a long series of prior years that we think it may be assumed with entire safety that the earnings for the future will more than suffice to meet the amount in question, \$6,600,000.

The Government directors are quite aware that, on a review of the propositions made to the different classes of security holders, the proposition made to the Government to pay the principal and interest of the debt in 3 per cent bonds at par is very much below the proposition made in respect to the holders of first mortgage bonds which are prior to the Government lien and in respect to the holders of many other

classes of securities. It is, however, to be remembered that the securities which support the first mortgage bonds, those which support the 8 per cent sinking fund bonds, or the collateral 6 per cent notes, or the collateral trusts, are securities which assure to the holders of these bonds the full payment of the amounts due them.

The Government to-day is only secured by a second mortgage, and its lien is imperfect and incomplete. It is for this reason impossible to so marshal the securities intended to be issued as to give to the Government as favorable a settlement as must be offered to those holding security of a higher class. The real question to be considered is whether the proposition to the Government is a better proposition and will secure a better return to it than it could obtain by resorting to a foreclosure of its lien. We make the recommendation contained in this report because we believe that the amount realized by the Government in this way will be greater than could possibly be derived by compulsory process.

Respectfully submitted.

E. ELLERY ANDERSON,
J. W. DOANE,
FITZHUGH LEE,
JOSEPH W. PADDOCK,
Government Directors.

Hon. HOKE SMITH,
Secretary of the Interior, Washington, D. C.

